

Money Forks: Crypto-Regulation at the G20

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Executive Summary

Cryptocurrencies have been placed on the G20 agenda for the first time during the Argentinian presidency. This is in response to a number of perceived risks to financial stability and connections to illicit activity. There was speculation that the G20 could pioneer coordinated global regulatory action on cryptocurrencies, however the final declaration has fallen short of this. While Financial Action Task Force (FATF) standards will be applied to counter terrorist financing and money laundering, all other risks will be monitored without any commitment to proactive regulation. This policy brief recommends that the G20 should implement dual strategies of regulation and investment to responsibly and progressively influence the trajectory of cryptocurrency and blockchain innovations. This would allow risks to be navigated and the significant potential held within this sector to be translated into economic and social benefits. The position the G20 has chosen instead leaves the crypto-market open to unpredictable and potentially dangerous changes.

New Money

Cryptocurrencies are virtual money based on blockchain technology. They use distributed ledgers to verify the creation and transfer of information through cryptographic algorithms. This differs from traditional fiat currencies, as no central regulatory body such as a bank is required. For the first time, cryptocurrencies are on the G20 agenda after a joint [Franco-German proposal](#) concerned about their potential dangers.

The criticisms placed against cryptocurrencies have been vociferous. Agustin Carstens, general manager of the Bank for International Settlements (BIS), has dubbed them 'a combination of a bubble, a Ponzi scheme and an environmental disaster' while European Central Bank executive board member Yves Mersch has likened them to a ['malignant creature' that lures individuals to an untimely death](#). South Korea's Prime Minister Lee Nak-yeon stated that unfettered cryptocurrency use amongst youths could lead to ['social pathological phenomena'](#). It is therefore pertinent to ask: are cryptocurrencies really a global threat?

Dirty Cash

These warnings come for a number of reasons. The rise of cryptocurrencies has been frenetic: from modest obscurity before 2017, to peak total market capitalisation of US\$835 billion in January 2018. Yet their short history has been a volatile one with their [current value of US\\$155 billion](#) being less than 20 per cent of this.

Crypto-currencies also have strong links with illicit activities. Their anonymity and easy transferability means they are used to facilitate a range of offences, including money laundering, drug dealing, tax dodging and terrorist financing. As much as [44 per cent of Bitcoin transactions are associated with illegal activity](#).

A lesser-talked about feature of crypto-currencies is their environmental impact. The energy consumption of Bitcoin is [larger than the entirety of Switzerland's at 64.5 TWh per year](#). 'Mining' cryptocurrencies - the computer process of verifying and processing transactions through cryptographic algorithms - is incredibly energy intensive. The question of crypto-regulation and the future of this asset class is intertwined with the battle against climate change.

Crypto-Crackdowns: Regulating the Market.

Given these risks it is unsurprising that cryptocurrencies have become an international concern. Many G20 member states have implemented national regulations. China is the most extreme of these, introducing legislation to [ban Initial Coin Offerings \(ICOs\) and restricting trading platforms](#). South Korea has also [made anonymous transactions illegal](#) in an attempt to clean up the sector. Others have expressed deep concern: India's finance minister has [vowed a crackdown on cryptocurrencies](#) and British MPs have called the crypto-market a '[wild west which required urged regulatory action](#)'.

Yet this sentiment is by no means globally unanimous, Switzerland is marketing itself as a '[crypto-nation](#)' to investors and has plans to introduce [conventional banking services for the industry](#). Similarly, the Venezuelan government has developed their own '[petro](#)' [cryptocurrency backed by oil gas and diamonds](#). This comes partly as a response to US and EU economic sanctions, and stands as a direct challenge to the economic order propped up by organisations such as the G20.

Japan offers a third way and is the [first country to create a national licensing program](#) to allow crypto-exchanges to self-regulate on the grounds that they

eliminate anonymous trading and enforce more responsibility in the sector.

Got some change?

Heterogeneous national action seems an inappropriate form of regulation for cryptocurrencies, which, unlike centrally banked sovereign currencies, are designed to transcend national borders. For the inherently global problems they pose, global solutions are also required. However, international regulation lags behind these FinTech developments and all eyes are on the G20 Summit in Argentina to see whether change is imminent.

The G20 stance has been a firm disavowal that 'crypto-currencies' are in fact currencies at all. Rather, they class them as 'crypto-assets' because they [lack money's key attributes](#) of a common means of payments, a stable store of value and a mainstream unit of account. Moreover crypto-currencies are currently considered [too small to pose a threat](#) to the financial system. These words have gone a long way to sooth nerves within the international community.

Despite this, the Financial Stability Board (FSB) has outlined the primary potential risks of crypto-currencies should markets continue to evolve; these include low

liquidity, volatility, and operational risks such as [cyber-attacks](#), [hard forks](#) and environmental degradation. If markets should become increasingly interlinked with the mainstream financial system, boom/bust cycles could have effects that ricochet beyond the crypto-world. The FSB also cautions of reputational damage to financial institutions that become too close to crypto-assets.

The G20 leaders have [declared](#) they will apply FATF standards to the use of cryptocurrencies for money laundering and terrorist financing. However, it remains to be seen how this will translate into policy as [jurisdictions retain flexibility as to how cryptocurrencies are categorised and thus regulated](#). Beyond this, the FSB is committed to '[vigilant monitoring](#)' of crypto-markets but falls short of substantial interventionary action.

A Small Bird within a Jet Engine

Cryptocurrencies may formulate less than 1 per cent of global GDP, but the 'Think 20' workstream has stated they could be a proverbial [small bird within a jet-engine](#) posing catastrophic risks to the global financial system. It is worth noting the 2008 financial crisis was the conception of the G20 leaders' summit, as economic powers aimed to avert chaos and stabilise the world economy through consensus. At

that time, the international economic community had [failed to predict](#) the financial crisis, and ten years on we must learn from these mistakes. The role of the G20 must evolve from reactive to proactive.

While monitoring the risks of cryptocurrencies is important, substantial regulation at a global level is needed. As a [‘post-Lehman financial innovation’](#) cryptocurrencies navigate the new landscape of financial architecture and regulation. How the G20 responds to them sets a precedent about how economic safety nets will apply to an ever-shifting financial system.

The G20 has proposed a trade-off between containing risk and supporting innovation, yet, in the case of cryptocurrencies and blockchain I argue this is not applicable. Regulatory action will not only protect against risks but also encourage investment. The CEO of ‘Circle’, a cryptocurrency start-up backed by Goldman Sachs, believes global regulation is the [‘next evolutionary step’](#) for cryptocurrency markets which will free them from their perilous reputation. Regulation remains unpopular within sectors of the crypto community as it is [blamed for price drops](#) and stands antithetical to the [‘bitcoin ideology’](#) of libertarian anarchism. However, from a wider perspective regulation should lead

to a stabilised system, which will allow the benefits of cryptocurrencies and blockchain technology to thrive as risks are more easily navigated.

The Other Side of the Coin...

The G20 recognises that the technology behind cryptocurrencies could potentially [improve financial inclusion and efficiency](#), however this is often a tagline gaining little focus in their reports. Taken more seriously, cryptocurrencies allow people in countries with failing banking systems an alternative route to financial inclusion. Citizens in many African countries have [turned to cryptocurrencies over centrally banked monies rife with inflation](#). There is also a growing industry of [cryptocurrency based remittance services](#) cutting the bureaucratic and financial cost of a third party. This demonstrates the potential of cryptocurrencies yet the volatility of the market provides a barrier for the sustainability of these systems.

The G20’s digital roadmap highlights a need for technological innovation and the vision of a digital future based principles of [openness, transparency and consensus](#). This is well matched with blockchain technology which operates on a peer-to-peer basis requiring consensus between nodes. As our time is increasingly characterised by economic fragmentation, anti-globalisation sentiment and a crisis of

trust in the global economic system following the 2008 financial crisis, Blockchain could present an opportunity. Julie Maupin argues that blockchain promotes a more decentralized and democratic order which [embeds transparency, accountability, and inclusiveness mechanism](#). Thus, the need for trust in powerful intermediaries is negated by giving power back to the world's citizens.

This can be harnessed for the benefit of the G20's goals beyond the economic sector. For example, blockchain could be used to stop environmental degradation by creating ['see-through' supply chains and monitoring carbon markets](#). In the health sector it could give people [access to and control over their health records](#). Blockchain powered digital voting being [tried in Tsukuba, Japan](#) is also a glimpse at the possibility the technology could hold for safeguarding against voter-fraud.

Decrypting crypto-futures

So, what might the G20 do to more responsibly and progressively incorporate cryptocurrencies and blockchain into the global financial and political system? One

crucial recommendation is regulation that matches the parameters of cryptocurrencies. This means coordinated international action that will stabilise the sector and protect against anonymous illegal activity. The G20 has made small steps towards this by applying FATF counterterrorism and anti-money laundering standards to cryptocurrencies.

However, they should extend regulation beyond this to safeguard against risks to financial stability. Moreover, regulation must be matched with investment and policy which directs these technologies towards positive impacts. The key challenges cryptocurrencies and blockchain face regarding stability, environmental impact and reputation will only be overcome through global cooperation. In uncertain times it is not enough for the G20 to passively profess their commitment to inclusive digital future. They must implement both regulation and investment that shapes the direction of change to realise this vision.

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